2007-05233/

# THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE APRIL 2007

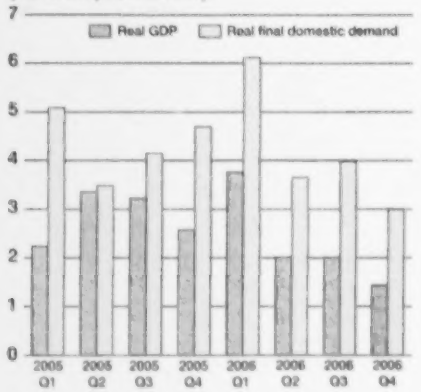
## OVERVIEW

- In the fourth quarter of 2006 real gross domestic product (GDP) grew 1.4% following gains of 2% in each of the two previous quarters. For 2006 as a whole, real GDP increased 2.7%, down from 2.9% in 2005.
- Domestic demand growth slowed in the fourth quarter. Real final domestic demand grew 3.0%, down from 4.0% in the third quarter. Growth in consumer spending on goods and services and business spending on plant and equipment remained solid but slowed. Business inventory accumulation fell.
- Real exports rose while real imports edged lower, raising the nominal trade surplus. However, a sharp deterioration in the investment income deficit lowered the current account surplus to $12.0 billion, or 0.8% of nominal GDP, from $23.1 billion in the third quarter. For 2006 as a whole, the current account surplus stood at $24.3 billion, or 1.7% of nominal GDP.
- Employment grew 2.4% in the fourth quarter, up from 0.6% growth in the third quarter. The unemployment rate in February 2007 was 6.1%, matching those in October and December 2006, the lowest level in 32 years.

### Real GDP increases 1.4%

Real GDP rose 1.4% in the fourth quarter of 2006. Final domestic demand growth remained solid, but slowed relative to the third quarter (Chart 1).

**Chart 1**
**Growth in real GDP and real final domestic demand**
per cent (annual rate)




### Consumer spending remains healthy

Real consumer expenditure grew 3.1% in the fourth quarter following an increase of 5.1% in the third. Spending on durables, especially automotive products, and semi-durables grew more modestly than in the third quarter, and spending on non-durables declined.

Personal income increased 6.0% in the fourth quarter. Labour income grew 6.3% after a 4.6% gain in the third quarter, given stronger employment growth and higher wage rates. Real personal disposable income rose 4.2% and

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of day, March 22, 2007.

**Main economic indicators**
(per cent change at annual rates unless otherwise indicated)

| | 2005 | 2006 | 2006:Q2 | 2006:Q3 | 2006:Q4 | | Most recent |
|---|---|---|---|---|---|---|---|
| **Real gross domestic product** | 2.9 | 2.7 | 2.0 | 2.0 | 1.4 | | – |
| Final domestic demand | 4.3 | 4.5 | 3.7 | 4.0 | 3.0 | | – |
| Government expenditure | | | | | | | – |
| Goods and services | 2.7 | 3.4 | 4.4 | 2.0 | 1.8 | | – |
| Gross fixed capital | 6.8 | 6.6 | 4.3 | 2.0 | 2.1 | | – |
| Consumer expenditure | 3.9 | 4.1 | 3.7 | 5.1 | 3.1 | | – |
| Residential investment | 3.2 | 2.9 | -4.7 | -6.9 | 0.3 | | – |
| Business fixed investment | 9.4 | 9 | 6.9 | 9.4 | 6.0 | | – |
| Non-residential construction | 7.9 | 10.7 | 8.2 | 10.4 | 10.5 | | – |
| Machinery and equipment | 10.5 | 8.0 | 5.8 | 8.5 | 2.3 | | – |
| Business inventory investment ($ billion) | 15.5 | 11.0 | 18.1 | 13.9 | 1.0 | | – |
| Exports | 2.1 | 1.3 | -1.3 | 3.5 | 4.8 | | – |
| Imports | 7.1 | 5.2 | 9.0 | 5.1 | -0.6 | | – |
| **Current account balance** | | | | | | | |
| (nominal $ billion) | 31.8 | 24.3 | 20.2 | 23.1 | 12.0 | | – |
| (percentage of GDP) | 2.3 | 1.7 | 1.4 | 1.6 | 0.8 | | – |
| Nominal personal income | 5.0 | 5.8 | -1.0 | 5.7 | 6.0 | | – |
| Nominal personal disposable income | 4.2 | 6.1 | -1.8 | 5.8 | 4.4 | | – |
| Real personal disposable income | 2.5 | 4.8 | -3.6 | 5.5 | 4.2 | | – |
| Profits before taxes | 10.6 | 5.7 | 2.3 | 12.4 | 2.5 | | – |
| **Costs and prices (%, y/y)** | | | | | | | |
| GDP price deflator | 3.2 | 2.2 | 2.9 | 1.5 | 0.5 | | – |
| Consumer Price Index (CPI) | 2.2 | 2.0 | 2.6 | 1.7 | 1.3 | 2.0 | Feb-2007 |
| Core CPI[1] | 1.6 | 1.9 | 1.8 | 2.1 | 2.2 | 2.4 | Feb-2007 |
| Unit labour costs | 2.3 | 2.9 | 3.0 | 2.1 | 2.7 | | |
| Wage settlements (total) | 2.3 | 2.5 | 2.7 | 2.6 | 2.1 | 2.3 | Dec-2006 |
| **Labour market** | | | | | | | |
| Unemployment rate (%) | 6.8 | 6.3 | 6.2 | 6.4 | 6.2 | 6.1 | Feb-2007 |
| Employment growth | 1.4 | 1.9 | 2.9 | 0.6 | 2.4 | 1.0 | Feb-2007 |
| **Financial markets (average)** | | | | | | | |
| Exchange rate (U.S. cents) | 82.6 | 88.2 | 89.1 | 89.2 | 87.8 | 86.34 | 22-Mar-07 |
| Prime interest rate (%) | 4.4 | 5.8 | 5.9 | 6.0 | 6.0 | 6.00 | 22-Mar-07 |

Note: Real values are in chained 1997 dollars.
[1] Core inflation excludes eight of the components of the CPI basket that display the greatest volatility, as well as the effect of changes in indirect taxes on the remaining components.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development Canada.

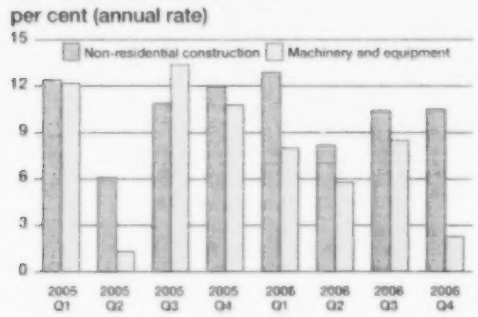
per capita real personal disposable income increased 2.9% to stand more than 23% above its trough in the second quarter of 1996. The personal savings rate was 1.5%, up from 1.3% in the third quarter.

Residential investment inched 0.3% higher in the fourth quarter following two consecutive declines. The home resale market strengthened, lifting agents' commissions and ownership transfer costs. Spending on renovations rose 9.2%. New construction fell 7.9%, the third consecutive quarterly decline.

## Business investment in plant and equipment remains strong

Supported by healthy profitability, business investment in plant and equipment grew 6.0% in the fourth quarter, with non-residential construction and machinery and equipment

Chart 2
**Growth in business investment in plant and equipment**




investment registering their 16th consecutive gains (Chart 2). Non-residential construction rose 10.5%, the sixth double-digit increase in eight quarters. Spending on engineering projects surged in the quarter.

Business investment in machinery and equipment rose 2.3% in the fourth quarter, a slowdown from the 8.5% pace in the third quarter. Capital spending on transportation equipment and software increased while that on telecommunications equipment, computers, furniture, and industrial and agricultural machinery weakened.

## Sharply lower business inventory accumulation

Businesses added $1.0 billion to inventories, down from the $13.9-billion accumulation in the third quarter. Wholesalers added little to inventories after a $7.2-billion investment in the previous quarter. Retailers reduced motor vehicle inventories, and retailers and manufacturers reduced stocks of non-durable goods. The inventory-to-sales ratio fell and remained below its historical average.

## Exports climb again

Real exports increased 4.8% in the fourth quarter, the second consecutive gain following two consecutive quarterly declines. Exports of automotive products, especially motor vehicles, recovered from production delays in the third quarter and led the improvement. Exports of non-automotive consumer goods and machinery and equipment also rose. The overall gain was partly offset by reduced exports of energy products given warmer than normal weather in much of North America. Exports of services increased 2.9%.

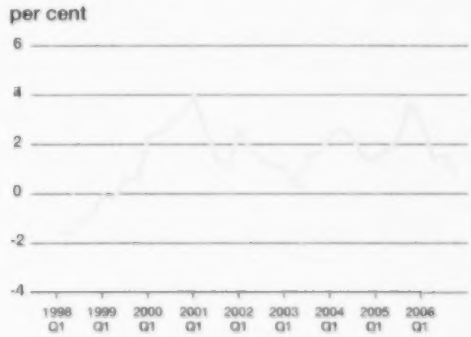
## Imports dip

Real imports edged 0.6% lower in the fourth quarter after gains of 9.0% and 5.1% in the second and third quarters. Imports of automotive and energy products fell. Rising consumer demand boosted imports of non-automotive consumer goods by 8.8%, and stronger business demand raised imports of machinery and equipment by 3.8%, the 14th gain in the last 15 quarters. Imports of services increased 3.0%.

## Smaller current account surplus

In the fourth quarter, a $5.2-billion improvement in the nominal trade surplus to $35.2 billion was more than offset by a $15.3-billion deterioration in the investment income deficit. Reduced profits from direct investments abroad lowered dividend receipts while record profits earned by non-residents on direct investment in Canada raised dividend payments. The current account surplus fell by $11.1 billion to $12.0 billion or 0.8% of nominal GDP (Chart 3).

Chart 3
**Current account as a percentage of nominal GDP**



## Healthy corporate profits continue

Corporate profits rose 2.5% in the fourth quarter. This maintained their share of nominal GDP at 14.1%, slightly below the historical high set at the end of 2005 but well above the historical average of 10.2%. The automotive industry, given increased exports, and the wood and paper industry registered sharp gains, helping to boost manufacturers' profits. The construction, telecommunications and transportation industries also contributed to the overall increase in profits. However, reduced demand and lower prices cut the revenues of the oil and gas industry, restraining the overall gain in corporate profits.

## Consumer price inflation remains subdued

The GDP deflator, a comprehensive measure of prices, rose 1.4% in the fourth quarter, up from 1.0% in the third, to stand 0.5% higher than a year earlier.

Year-over-year consumer price inflation increased to 2.0% in February 2007 from 1.2% in January, due mainly to higher gasoline prices and higher prices for fruits and vegetables. At 2.4%, core CPI inflation, which excludes the eight most volatile items and the effect of changes in indirect taxes, sat just above the 2% inflation target.

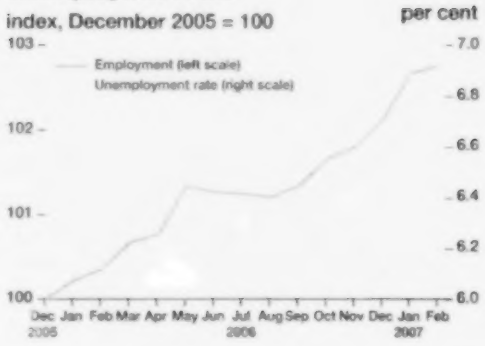
## Unemployment rate remains low

Employment grew 2.4% in the fourth quarter, a sharply higher pace than in the third quarter. Solid job growth in January and February 2007 raised net job creation to a healthy 449,600 since the end of 2005 (Chart 4). The participation rate stood at 67.5% in February, the same as in January and up from 67.2% at the end of 2006.

The unemployment rate in February dipped to 6.1% from 6.2% in January. The February rate matched those in October and December 2006, the lowest level in 32 years.

Hourly labour productivity for the total economy grew 0.7% in the fourth quarter, the same pace as in the previous quarter. Labour costs per unit of output rose in the fourth quarter to sit 2.7% higher than a year earlier.

Chart 4
**Employment and the unemployment rate**




## Bank of Canada holds policy rate steady

On March 6, the Bank of Canada held its key policy rate—the target for the overnight rate—unchanged at 4.25% for the sixth consecutive announcement after seven one-quarter-percentage-point increases over nine months through to May 2006. The Bank stated, "the current level of the target for the overnight rate is judged, at this time, to be consistent with achieving the inflation target over the medium term." On March 21, the U.S. Federal Reserve maintained a policy rate of 5.25% for the sixth consecutive Federal Open Market Committee decision. That followed 17 increases during a period of monetary tightening that the Federal Reserve initiated in June 2004. U.S. rates at all maturities exceed those in Canada.

The Canadian dollar closed at 86.34 U.S. cents on March 22.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Department of Finance Distribution Centre at 613-995-2855. For other inquiries about this publication, contact Steven James at 613-992-4321.
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